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IN REPLY REFER TO

PIC 730.3.B.2.4

December 11, 2020
20-PIC-006(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
CORPORATE AUDIT DIRECTORS, DCAA
ASSISTANT DIRECTORS, HQ, DCAA

SUBJECT: Audit Alert on Coronavirus Legislation and Regulations

What You Need to Know

This memorandum provides guidance on legislation enacted in response to the Coronavirus national emergency. It provides information on the Coronavirus Aid, Relief, and Economic Security (CARES) Act, the Families First Coronavirus Response Act (FFCRA), and other Department of Defense (DoD) guidance.

What Auditors Need to Do

Each contractor dealt with and many continue to deal with the impact of COVID-19 in ways that make sense for its unique circumstances. During the planning phase of an audit, the auditor should discuss with the contractor which relief opportunities, if any, the contractor chose to employ. Furthermore, the auditor should ask for any COVID-19 company policies and procedures, as well as any changes or exceptions to policies and procedures in effect before the pandemic.

The audit team should be familiar with the key provisions of the legislation and regulations discussed in this memorandum to determine how an audit may be impacted. See Enclosure 1 for details of the legislation.

When planning the incurred cost audit, the audit team should also refer to Enclosure 2 for frequently asked questions that address what we believe will be the more common scenarios for CARES Act provisions for loans and paid leave.

Likewise, when performing forward pricing audits, the audit team should be aware that most of the relief provisions discussed in this memorandum currently expire in calendar year 2020, and may or may not have an impact on future pricing audits. See Enclosure 3 for frequently asked questions regarding forward pricing audits.

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Questions and Further Information

FAO personnel with additional questions regarding this audit alert should contact their regional or CAD offices. Regional/CAD personnel with questions regarding this audit alert should contact Ms. Barbara Richon, Chief, Policy Incurred Cost Division or Ms. Jennifer Kang, Chief, Pricing and Special Projects Division or via e-mail at DCAAPolicyCovid19@dcaa.mil.

/Signed/

Martha E. McKune

Assistant Director, Policy and Plans

Enclosures:

- (1) Legislation
- (2) Incurred Cost FAQs
- (3) Forward Pricing FAQs

DISTRIBUTION: E

Legislation

Coronavirus Aid, Relief, and Economic Security (CARES) Act

The CARES Act, enacted on March 27, 2020, provides aid and relief in response to the national health emergency. Major sections that could be used by contractors are:

- *Paid Leave Reimbursement* (Section 3610);
- *Paycheck Protection Program* (Sections 1102 and 1106);
- *Employee Retention Credit* (Section 2301); and
- *Payroll Taxes Deferral* (CARES Act Section 2302).

See the table below for more details of these and other sections.

CARES Act Sections	Description	Dates
1102	<p>A Paycheck Protection Program (PPP) loan is a Small Business Administration (SBA) loan designed to provide a direct incentive for small businesses to keep their workers on the payroll. The proceeds can be used for:</p> <ul style="list-style-type: none"> • payroll costs; • costs related to the continuation of group health care benefits; • employee salaries, commissions, or similar compensations; • payments of interest on any mortgage obligation (no prepayments or principal); • rent (including rent under a lease agreement); • utilities; and • interest on any other debt obligations that were incurred before the covered period. • The PPP limits employee wages/salaries to \$100,000, which should be prorated based on the period involved. • 	<p>The covered period is either:</p> <ul style="list-style-type: none"> • the 24-week (168-day) period beginning on the PPP loan disbursement date, or • if the borrower received its PPP loan before June 5, 2020, the borrower may elect to use an eight-week (56-day) covered period. <p>At this time, the covered period ends no later than December 31, 2020.</p>
1106	The PPP loan can be forgiven if the funds are used for:	

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	<ul style="list-style-type: none"> • payroll costs, interest on mortgages, • rent, and • utilities. <p>At least 60 percent of the forgiven amount <u>must</u> have been used for payroll. Borrowers are generally eligible for forgiveness for the costs incurred during the covered period.</p>	
2301	<p>Employee Retention Credit is a fully refundable tax credit for employers equal to 50 percent of qualified wages (including allocable qualified health plan expenses) that eligible employers pay their employees.</p> <ul style="list-style-type: none"> • Applies to qualified wages paid after March 12, 2020, and before January 1, 2021. • The maximum amount of qualified wages taken into account with respect to each employee for all calendar quarters is \$10,000, so that the maximum credit for an eligible employer for qualified wages paid to any employee is \$5,000. • The credit is allowed against the employer’s share of social security taxes. An eligible employer <u>can receive both</u> the tax credit for qualified leave wages under the FFCRA and the Employee Retention Credit under the CARES Act, but <u>not</u> for the same wages. • An eligible employer may <u>not</u> receive the Employee Retention Credit if the eligible employer receives a PPP loan that is authorized under the CARES Act. 	The credit applies to qualified wages paid after March 12, 2020, and before January 1, 2021.
2302	Section 2302 allows employers to defer the deposit and payment of the employer's portion of Social Security taxes. An employer that receives a PPP loan is entitled to defer the payment and deposit of the employer's share of Social Security tax, even if the loan is later forgiven.	Expires December 31, 2020
3606	This section permits the tax credits in FFCRA Sections 7001 and 7003 to be advanced to employers.	Expires December 31, 2020

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3608	This section delays the minimum required contributions for single employer pension plans to January 1, 2021.	Extends the deadline for minimum contributions to January 1, 2021
3610	<p>This Paid Leave section allows at the contracting officer discretion, but does not fund, agencies to reimburse at the minimum applicable contract billing rates (not to exceed an average of 40 hours per week):</p> <ul style="list-style-type: none">• Any paid leave, including sick leave, a contractor provides to keep its employees or subcontractors in a ready state from March 27, 2020, through December 11, 2020, including to protect the life and safety of Government and contractor personnel, during the public health emergency declared for COVID-19.• A contractor may only receive reimbursement if its employees or subcontractor employees cannot perform work on a government-owned, government-leased, contractor-owned, or contractor-leased facility or site approved by the Federal Government for contract performance due to closures or other restrictions, and are unable to telework because their job duties cannot be performed remotely during the public health emergency declared for COVID-19.• Approval of reimbursements of Section 3610 paid leave is at the discretion of the contracting officer.	Paid leave period: March 27, 2020 through December 11, 2020 (not December 31).

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Families First Coronavirus Response Act (FFCRA), enacted March 18, 2020, provides relief to employees and employers through expanded employee leave and a variety of employer tax credits.

FFCRA Sections:	Description	Dates
3102	Employer must provide paid leave from the 11th day onward for employees who take "public health emergency leave" to care for a child because of the closure of school/child care due to a declaration made by Federal, State, or local government.	Effective April 2, 2020; Expires December 31, 2020
5102	Employees are entitled to a special class of leave for COVID-19 related illness. The leave is for personal illness, quarantine, caring for someone else who is sick, or caring for minor children. Employers may not require an employee to use other paid leave before the employee uses the paid sick time under this section.	Effective April 2, 2020; Expires December 31, 2020
7001	A 100 percent credit taken against payroll taxes for all leave given to employees under Section 5102. The credit is increased by the amount of qualified health plan expenses that are properly allocable to the qualified sick leave wages for which the credit is allowed. The credit in excess of payroll taxes is refundable. However, an employer cannot take this credit and the credit under Internal Revenue Code (IRC) Section 45S.	Expires December 31, 2020
7003	A 100 percent credit taken against payroll taxes for all leave given to employees under Section 3102 and the Family Medical Leave Act (FMLA). The credit is increased by the amount of costs incurred to maintain health plan coverage for employees.	Expires December 31, 2020
7005	The credit allowed in Sections 7001 and 7003 is increased by the amount of IRC Section 3111(b) tax paid on qualified sick leave wages or qualified family leave wages.	Expires December 31, 2020

Additional Guidance

Defense Pricing and Contracting (DPC) issued guidance, including:

Legislation

- CARES Act Section 3610 Implementation (2020-O0013, Revision 2) – This class deviation provides guidance to contracting officers for implementing section 3610 and provides deviation clause DFARS 231.205-79 CARES Act Section 3610 – Implementation.
- Section 3610 Reimbursement Requests (2020-O0021, Revision 1) – This class deviation provides guidance to contracting officers for reviewing and processing contractor requests for reimbursement under Section 3610, and provides three checklists the contracting officer may use to review the contractor’s request.
- Implementation Guidance for Section 3610 of the CARES Act, Frequently Asked Questions.
- Allowability of Contractor Costs – Donation of Unused Leave in Response to the COVID-19 National Emergency.

A complete listing of DPC guidance issued in response to COVID-19 can be found at:

<https://www.acq.osd.mil/dpap/pacc/cc/COVID-19.html>

FREQUENTLY ASKED QUESTIONS – INCURRED COST

Payroll Protection Program Loans, Loan Forgiveness, and Subsequent Credits to the Government

Question 1: How should credits resulting from forgiven PPP loans be applied?

Answer: The amount of a PPP loan that is forgiven will apply as a credit or cash refund under FAR 31.201-5. The credit should apply to contract costs in the same manner in which the PPP loan funds were originally spent by the contractor. For example, if a portion of the forgiven PPP loan was used to pay facility rent, the cost of facility rent should be credited. If that rent is part of an indirect cost pool, then the indirect cost pool would be reduced by the credit in the period in which the loan is forgiven. If a PPP loan was expended for direct contract cost and the contract can no longer be credited (i.e., it is complete), then the credit will be returned to the Government in a manner agreed to by the ACO.

Section 1106 has strict documentation requirements and a company certification. This documentation should be available to the auditors.

Question 2: Do the requirements of FAR 31.201-1, Composition of Total Cost, and FAR 31.201-5, Credits, apply to the provisions in the FFCRA and CARES Act?

Answer: Yes. FAR 31.201-5, Credits, states “the applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund.” FAR 31.201-1, Composition of Total Cost, states that total cost is the sum of the direct and indirect costs allocable to the contract less any allocable credits.

To the extent that PPP credits are allocable to costs allowed under a contract, the Government should receive a credit or a reduction in billing for any PPP loans or loan payments that are forgiven. Furthermore, any reimbursements, tax credits, etc. from whatever source that contractors receive for any COVID-19 Paid Leave costs should be treated in a similar manner and disclosed to the government. **Additional Guidance**

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- CARES Act Section 3610 Implementation (2020-O0013, Revision 2) – This class deviation provides guidance to contracting officers for implementing Section 3610 and provides deviation clause DFARS 231.205-79 CARES Act Section 3610 – Implementation.
- Section 3610 Reimbursement Requests (2020-O0021, Revision 1) – This class deviation provides guidance to contracting officers for reviewing and processing contractor requests for reimbursement under Section 3610, and provides three checklists the contracting officer may use to review the contractor’s request.
- Implementation Guidance for Section 3610 of the CARES Act, Frequently Asked Questions.

FREQUENTLY ASKED QUESTIONS – INCURRED COST

- Allowability of Contractor Costs – Donation of Unused Leave in Response to the COVID-19 National Emergency.

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Question 3: If a contractor has cost-type contracts and its PPP loan is forgiven, will these contracts receive a credit due to the loan forgiveness?

Answer: Maybe. The amount of a PPP loan that is forgiven will apply as a credit or cash refund under FAR 31.201-5. The credit should apply to contract costs in the same manner in which the PPP loan funds were originally spent by the contractor. For example, if a portion of the forgiven PPP loan was used to pay facility rent, the cost of facility rent should be credited. If that rent is part of an indirect cost pool, then the indirect cost pool would be reduced by the credit in the period in which the loan is forgiven.

However, PPP loans may be used for expenses that do not include flexibly-priced contracts. For example, a business may wish to use the PPP to pay its employees for work they would have performed for commercial customers and request support under other CARES Act or FFCRA provisions for time employees would have spent supporting federal customers. In this scenario, forgiven loan amounts used solely to pay employees working on commercial effort would not create a credit or refund for the Government.

Question 4: How would a forgiven PPP loan be presented in the incurred cost proposal?

Answer: First, be aware that the loan forgiveness may not have been granted in the same accounting period as the loan issuance. The contractor may claim allowable costs in the year incurred, and provide the related credits to the government when the loan is forgiven, even if the contractor is expecting the loan forgiveness.

The presentation of credits and refunds to the Government in the incurred cost proposal depends on each contractor's cost accounting structure and practices. PPP loan amounts that were expended on flexibly-priced Government contracts and were subsequently forgiven should be credited to those contracts in the same manner in which the original funds were expended. If a credit results due to a specific contract's ODC costs, then that credit should be accounted for as a credit to ODCs for that contract in the incurred cost proposal for the period in which the loan is forgiven.

Question 5: How should a contractor present costs for which PPP loan forgiveness has been requested but not yet approved at the time the incurred cost proposal is due?

Answer: Until forgiven, PPP loans are a liability of the contractor and, therefore, should be on the balance sheet. Costs paid for by these loans are normal contract costs.

FREQUENTLY ASKED QUESTIONS – INCURRED COST

CARES Act Paid Leave

Question 6: How should a contractor classify COVID-19 leave costs under Section 3610?

Answer: The Department recommends that Section 3610 paid leave costs be charged to a newly created cost category, Other Direct Costs (ODC) COVID-19. Costs from ODC-COVID-19 may be allocated to the applicable contracts based on some reasonable, agreed upon allocation. In some situations, it may be more appropriate to charge these costs through indirect cost pools (overhead, G&A, etc.). In either case, the contracting officer and contractor should work together, as appropriate, to determine how the costs should be charged to the contracts.

Question 7: Does the incurrence of COVID-19 leave costs trigger a cost accounting practice change?

Answer: No. 48 CFR 9903.302-2(a) states that “the initial adoption of a cost accounting practice for the first time a cost is incurred...is not a change in cost accounting practice.” By creating a new category of costs in the Class Deviation, the Department has determined that cost accounting practices initiated to account for Section 3610 leave costs are not subject to the regulations for cost accounting practice changes set forth in FAR Part 30.603 and 30.604.

Question 8: How did the contractor seek reimbursement for CARES Act Section 3610 paid leave costs?

Answer: The process for requesting Section 3610 reimbursements for contracts with the Department of Defense is determined by agreement with the ACO and is governed by DPC Class Deviation 2020-O0021 Revision 1—Section 3610 Reimbursement Requests, dated October 14, 2020.

When auditing assertions that involve Section 3610 costs, auditors should become familiar with the agreement entered into between the contractor and Government and, if selected for testing, verify that the costs as presented in the incurred cost proposal are consistent with the methods of cost accumulation and the determinations of allowability in the agreement.

Auditors should note that CARES Act Sections 2101 through 2116 provide unemployment insurance articles. Auditors should ensure that 3610 requests for reimbursement do not include costs for which the employee received unemployment benefits. Under the CARES Act, employees do not have to be laid off or furloughed to collect unemployment benefits.

FREQUENTLY ASKED QUESTIONS – FORWARD PRICING

Question 1: Do I need to be aware of the provisions of the CARES Act impact when performing an audit of forward pricing?

Answer: Yes. Most of the provisions of the CARES Act have a potential impact on forward pricing.

- The CARES Act extends to December 31, 2020. If a contractor's FY 2021 starts prior to December 31, 2020, its FY 2021 indirect rates could possibly be impacted by CARES Act.
- If costs incurred during calendar year 2020 are used as part of the basis of estimate for the proposal, the auditor needs to understand how the costs incurred are impacted by the CARES Act and what impact they have on the future estimates.

Question 2: Should a contractor's estimates assume that the CARES Act relief provisions will be extended into calendar year 2021 and beyond when developing future estimates?

Answer: Currently, there is no enacted legislation that would extend the CARES Act into calendar year 2021. If the contractor's estimating assumptions include extending CARES Act relief provisions beyond the dates provided in the legislation then these would represent contingencies under FAR 31.205-7. Contingencies may arise from presently known or unknown conditions that the effect of which cannot be measured so precisely as to provide equitable results to the contractor and to the Government. Contingencies should be excluded from cost estimates under the elements of cost, but should be disclosed separately (including the basis upon which the contingency is computed) to facilitate the negotiation of appropriate contractual coverage.

Question 3: Are paid leave costs for COVID-19 an allowable future cost?

Answer: Possibly. The paid leave reimbursed for COVID-19 under Section 3610 is limited to the period of March 27, 2020, to December 11, 2020. Section 3610 does not prohibit the reimbursement of paid leave prior to or after that period. Therefore, the reimbursement of the paid leave costs (other than Section 3610 paid leave) would be allowable charges to a contract if they were allowable, allocable, and reasonable per the existing regulations, contract terms, and consistent with the contractor's accounting practices. If a contractor is proposing future paid leave for COVID-19, the auditor should obtain and review the contractor's policy and methodology used for paid leave related to COVID-19 and evaluate it against the applicable cost principles.

Question 4: Should a contractor's forward pricing estimates consider the impact of COVID-19?

Answer: Yes. The circumstances and manner in which each contractor's estimates have been impacted by COVID-19 will vary. However, the contractor should consider how COVID-19 and changes in response to COVID-19 have impacted its future operations.

FREQUENTLY ASKED QUESTIONS – FORWARD PRICING

Question 5: When certified cost or pricing data is required, what is a contractor required to disclose in its proposal related to the impact of COVID-19?

Answer: The proposal data should include cost or pricing data reflecting the prospective cost required to provide the product or service during the defined period of performance. When certified cost or pricing data is submitted, the contractor is certifying that, to the best of its knowledge and belief, the cost or pricing data (as defined in FAR 2.101 and as required under FAR 15.403-4) the submissions are accurate, complete, and current as of a specific date.

The auditor must assess the disclosure requirements against the cost or pricing data definition. The key considerations include:

- Factual not judgmental;
- Reasonably expect to affect price negotiations (significantly);
- Verifiable – this would include the data forming the basis for judgment; and
- Contributes significantly to the soundness of estimates – does not have to form the basis of the estimate.

In assessing the proposal and expectation for disclosure, the auditor needs to be aware of the items in which a clear decision is made by someone in authority within the contractor organization to act, and the outcome is readily apparent. Generally, circumstances that may appear unclear or uncertain, but a decision has already been made by the contractor management, which have a significant potential impact on future costs, should be disclosed.

Question 6: There is an existing Forward Pricing Rate Agreement (FPRA), Forward Pricing Rate Recommendation (FPRR), or audit report on forward pricing rates that were finalized prior to the COVID-19 pandemic. What should happen now?

Answer: The auditor should be aware of changes or decisions that have a potential impact on the contractor's indirect rates and assess the materiality of the impact on existing audit opinions expressed on the rates, FPRAs or FPRRs. Rates require updates to remain accurate, complete, and current as changes at the contractor occur. If the prior audit, FPRA, or FPRR does not consider the potential impact of COVID-19 and the impact is determined to be significant, action may be required to protect the Government's interest. The auditor should determine if the contractor plans to submit an updated proposal and notify the contracting officer of the contractor response. The auditor should work with the contracting officer and cost monitor to develop a plan to evaluate and update the forward pricing rates.

Question 7: The DPC provided guidance on temporarily allowing the costs of donated leave. Should a contractor's estimates assume that the costs of donated leave would be allowable in calendar year 2021 and beyond when developing future estimates?

Answer: Currently, there is no enacted legislation that would extend the allowability of donated leave to beyond December 2020. If a contractor's estimating assumptions include extending this rule beyond the date provided in the DPC guidance they would represent contingencies under

FREQUENTLY ASKED QUESTIONS – FORWARD PRICING

FAR 31.205-7. Contingencies may arise from presently known or unknown conditions, the effect of which cannot be measured so precisely as to provide equitable results to the contractor and to the Government. Contingencies should be excluded from cost estimates under the elements of cost, but should be disclosed separately (including the basis upon which the contingency is computed) to facilitate the negotiation of appropriate contractual coverage.

Question 8: Are there other COVID-19 relief measures that I should be considering when performing forward pricing audits?

Answer: Yes. The Department of Defense's response to the COVID-19 pandemic includes using the provisions in the CARES Act, as well as using class deviations and existing FAR and DFARS flexibilities. One key flexibility impacting forward pricing is the ability to grant no cost extensions. COVID-19 caused closures or delays can result in the Government granting no cost extensions. This shift in contract performance can result in significant impacts in a contractor's indirect cost bases.

Question 9: Is it permissible for a contractor to insert a bottom line COVID-19 percentage adjustment without support in its proposals?

Answer: No. COVID-19 does not alleviate the responsibility of a contractor to provide sufficient support for its estimates. In accordance with FAR Part 15, a contractor's proposal should be based on a well-supported basis of estimate (including COVID-19 costs set out as contingencies). To demonstrate reasonableness, the contractor must show how it computed the proposed COVID-19 costs while also providing the supporting data and appropriate explanations.

Question 10: Are there any common risk factor trends auditors should be aware of when auditing forward pricing?

Answer: Yes. The pandemic has resulted in changes to the way companies are doing business and is influencing management decisions related to short/long term operations and policies and procedures. Below are a few items to consider when planning forward pricing audits.

- How has the pandemic impacted current operations - How the contractor's current operations were impacted by the pandemic can provide a lot of information to consider in audits. While some contractors may experience limited disruptions, others may have been significantly impacted. Increased telework, facility closures, layoffs, changes in historical spending trends, and contract delays all provide insight into possible impact to future operations. It is important to understand how historical data used as the basis for estimates was impacted and if those impacts will continue into the future.
- What changes to the contractor's policies and procedures occurred or are planned - Operating in a pandemic has changed how contractors function. This has resulted in contractors revising existing policies and procedures or adopting new policies and

FREQUENTLY ASKED QUESTIONS – FORWARD PRICING

procedures. We are seeing increased use of telework, revisions to leave policies, and expansion of employee benefits or company reimbursed expenditures. The allowability of such costs would be determined using the existing applicable cost principles. The auditor should be aware of the contractor's new or pending policies and procedures to assess the impact on future estimates.

- Have production processes changed - The need for employee safeguards have resulted in the contractor looking at its production processes and implementing changes to protect employee health and wellbeing. These changes can influence the accuracy of using historical information and learning curves on future estimates.